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Supreme Court of the United States

October Term, 1951.

No. 8[redacted]109

GIRARD TRUST CORN EXCHANGE BANK, As Trustee of a Trust Under Deed of Albert R. Gallatin Welsh Dated March 19, 1935,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit and Brief in Support of Petition.

PHILIP PRICE,
CARROLL R. WETZEL,
GEORGE CRAVEN,
13th Floor, Packard Bldg.,
Philadelphia 2, Pa.,
Attorneys for Petitioner.

BARNES, DECHERT, PRICE,
MYERS & RHOADS,
13th Floor, Packard Bldg.,
Philadelphia 2, Pa.,
Of Counsel.

INDEX.

	Page
PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.	1
Opinions Below	1
Jurisdiction	1
Question Presented	2
Statutes Involved	2
Statement	2
Specification of Errors to Be Urged	4
Reasons for Granting the Writ	4
Conclusion	9
BRIEF IN SUPPORT OF PETITION	11
Argument	11
The Statutory Provisions	11
History of Statutes	14
The Legislative Intent	17
The Confused State of the Law	23
Conclusion	27
SUPPLEMENT TO PETITION AND BRIEF	29
Sections 22(k), 23(u) and 171 of Internal Revenue Code, as in Force in 1948	29
Section 117(a), (b) and (c) of Revenue Bill of 1941 (H. R. 5417, 77th Cong., 1st Sess.) as Passed by Senate	32
Statement of Randolph E. Paul, Tax Adviser to Secretary of Treasury, on Revenue Revision of 1942 (Hearings Before Committee of Ways and Means, 77th Cong., 2nd Sess., p. 92)	34

TABLE OF CASES CITED.

	Page
Douglas v. Willcuts, 296 U. S. 1 (1935)	13, 15
Fairbanks v. Commissioner, 191 F. 2d 680 (C. A. 9, 1951), cert. denied March 31, 1952, 72 S. Ct. 648	7, 23
Gould v. Gould, 245 U. S. 151 (1917)	14
Helvering v. Fitch, 309 U. S. 149 (1940)	13, 15
Helvering v. Fuller, 310 U. S. 69 (1940)	13, 15
Helvering v. Leonard, 310 U. S. 80 (1940)	13, 15
Izrastzoff v. Commissioner, 15 T. C. 573 (1950), affd. 193 F. 2d 625 (C. A. 2, 1952)	24
Koshland v. Helvering, 298 U. S. 441 (1936)	20
Laughlin's Estate v. Commissioner, 167 F. 2d 828 (C. A. 9, 1948)	6, 7, 23, 24, 25
Mahana v. United States, 88 F. Supp. 285 (Ct. of Cls., 1950), cert. denied, 339 U. S. 978 (1950)	17
M. E. Blatt Co. v. United States, 305 U. S. 267 (1938)	20
Reid's Estate v. Commissioner, 15 T. C. 573 (1950), affd. 193 F. 2d 625 (C. A. 2, 1952)	24
Stewart v. Commissioner, 9 T. C. 195 (1947)	7, 8, 9, 25, 26

STATUTES AND REPORTS CITED.

Page

H. R. Rep. No. 1203, 77th Cong., 1st Sess., p. 11 18

H. R. Rep. No. 2333, 77th Cong., 2nd Sess., p. 46 ..15, 16, 21

Internal Revenue Code (Title 26, U. S. C.):

Section 22(b)(4) 8, 25

Section 22(k) 2, 4, 5, 7, 8, 11, 12, 13, 14, 16 17, 18, 25, 29

Section 23(u) 5, 8, 11, 12, 17, 30

Section 143(b) 2

Section 162(b) 5, 7, 13, 22, 24

Section 162(d) 5, 7, 12, 22

Section 171 .....2, 4, 7, 11, 17, 18, 23, 24, 30

Section 171(a) 13, 16, 30

Section 171(b) 5, 7, 8, 12, 13, 14, 16, 17, 18, 22, 24, 25, 26, 31

Reg. 111, Sec. 29.23(u)-(1), Example (2) 20

Revenue Act of 1942, Section 120 11

Revenue Bill of 1941 (H. R. 5417, 77th Cong., 1st Sess.) as passed by Senate:

Section 117 .....17, 32

Sen. Rep. No. 673, Part 1, 77th Cong., 1st Sess., p. 33.. 19

Sen. Rep. No. 1631, 77th Cong., 2d Sess. 15, 16, 21

Statement of Randolph E. Paul, Tax Adviser to Secretary of Treasury, on Revenue Revision of 1942 Hearings before Committee of Ways and Means of House of Representatives, 77th Cong., 2d Sess., p. 92 .....15, 21, 34

Title 28, U. S. C., Section 1254 1

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1951.

No.

GIRARD TRUST CORN EXCHANGE BANK, AS TRUSTEE OF A TRUST UNDER DEED OF ALBERT R. GALLATIN WELSH DATED MARCH 19, 1935,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit entered in the above-entitled case on February 27, 1952, affirming the decision of the Tax Court of the United States.

OPINIONS BELOW.

The opinion of the Tax Court (R. 15a) is reported in 16 T. C. 1398. The *per curiam* opinion of the Court of Appeals (R. 22) is reported in 194 F. 2d 708.

JURISDICTION.

The judgment of the Court of Appeals was entered February 27, 1952 (R. 23). The petitioner filed a petition for rehearing, which was denied March 25, 1952 (R. 24). The jurisdiction of this Court in invoked under Section 1254, Title 28, U. S. C.

QUESTION PRESENTED.

Whether an amount paid to a divorced wife who is a nonresident alien of the United States, in satisfaction of her claim for alimony under a separation agreement and divorce decree, from the principal of a trust created by her deceased husband for his own benefit during his lifetime, is subject to income withholding tax under Section 143(b) of the Internal Revenue Code. This question depends on whether amounts so paid from trust principal constitute gross income to the wife under Section 22(k) of the Code.

STATUTES INVOLVED.

The pertinent statutes are Sections 22(k) and 171 of the Internal Revenue Code, Title 26, U. S. C., which are set forth in a supplement to this petition at pages 29 to 31.

STATEMENT.

Albert R. Gallatin Welsh and Gabrielle B. Welsh were married October 25, 1933. There were no children of the marriage (R. 3a). They were divorced on December 20, 1938 (R. 3a-4a). Albert subsequently remarried. He died December 1, 1944 survived by his second wife, Helene Welsh, and two sons of that marriage, all of whom were living during the taxable year, 1948 (R. 4a).

At the time of his death Albert was obligated under a separation agreement dated May 16, 1938 and the divorce decree of December 20, 1938 to pay Gabrielle for her support $400 a month until her death or remarriage. During 1948 Gabrielle was living and had not remarried (R. 3a-4a, 8a, 11a).

By a deed of trust dated March 19, 1935 Albert had created an irrevocable trust with Girard Trust Company (now Girard Trust Corn Exchange Bank) and Charles N. Welsh, Jr., as trustees. Gabrielle was not made a beneficiary of the trust nor, indeed, was she mentioned at all in the deed of trust. The deed reserved to Albert the income

for life and a general power of appointment over the property by will (R. 4a, 15a).

By his will Albert exercised the power over the trust fund by appointing the property in further trust with the same trustees and directing that the trustees pay one-half of the income to his second wife, Helene, until her death or remarriage and the balance of the income to his children, with provision for distribution of the principal on the death or remarriage of Helene. Helene remained unmarried during 1948. The will made no provision for Gabrielle (R. 4a, 12a).

Albert left no substantial estate out of which the claim of Gabrielle under the separation agreement and divorce decree could be satisfied. In proceedings instituted by Gabrielle in the state courts of Pennsylvania to subject the trust corpus to her claim as a creditor of Albert's estate, an adjudication was made on October 1, 1947 awarding to Gabrielle from the principal of the trust the total of all unpaid monthly sums of $400 that had accrued from the date of Albert's death and payments to be made thereafter at the rate of $400 per month (R. 4a-5a, 13a-14a).

Since the date of Albert's death the trustees have paid the entire trust income regularly each year including the year 1948 to Helene and the two children of Albert, and such income for 1948 was reported by them for federal income tax purposes (R. 5a).

The petitioner in 1948 set aside $18,000 from the *principal* of the trust to satisfy the delinquent payments which were due Gabrielle subsequent to Albert's death. Of that amount, petitioner paid $12,600 to Gabrielle in 1948 and retained the balance of $5,400 to cover liability, if any, for withholding tax at the rate of 30% (R. 5a-6a).

Gabrielle is a nonresident alien of the United States and a citizen of France and is not engaged in business in the United States (R. 6a).

The Tax Court held that the amount in question was income to Gabrielle under Section 22(k) of the Internal

Revenue Code and was subject to withholding tax (R. 15a-20a), and the Court of Appeals in a *per curiam* opinion affirmed on the opinion of the Tax Court (R. 22).

SPECIFICATION OF ERRORS TO BE URGED.

The Court of Appeals erred:

1. In holding that the payment in question constitutes gross income to the wife under Section 22(k) of the Internal Revenue Code and is subject to income withholding tax.

2. In failing to hold that such payments from a trust fund are governed by Section 171 of the Internal Revenue Code, and not by Section 22(k), and that when they are paid from trust principal they do not constitute gross income to the wife.

3. In affirming the decision of the Tax Court.

REASONS FOR GRANTING THE WRIT.

1.

This case presents for the first time in this Court an important question of federal income taxation which should be settled by this Court. It is the only case which has held that payments made to a divorced wife from principal or tax exempt income of an estate or trust constitute taxable income to the wife when all the taxable income of the estate or trust has been distributed and taxed to others. We believe it is the only case which has held that a payment from principal or tax exempt income of an estate or trust is taxable as income to the recipient in any circumstances, when all taxable income of the estate or trust has been paid to others. The question is of wide public importance and is likely to arise frequently, especially in estates of decedents who are obligated to make periodic payments of alimony to their divorced wives. It is one which must be settled eventually by this Court and which should be settled as early as

possible in order to avoid the confusion which presently exists on the question.

Section 22(k) of the Internal Revenue Code provides for including in the income of a divorced wife certain periodic payments to her in discharge of the husband's legal obligation under a divorce decree or a written instrument incident to the divorce. Section 23(u) allows as a deduction to the husband payments made by him to the wife which are includible in the wife's income under Section 22(k). Section 22(k) refers to Section 171(b) of the Code for the rule in cases where payments to the wife are made from an estate or trust. Section 171(b) states that in computing the net income of the estate or trust and of the wife, the wife shall be considered the beneficiary specified in the provisions of the income tax statutes governing income of estates and trusts. Section 162(b) of the Code provides that where income of an estate or trust is to be distributed currently, the income is deductible by the estate or trust and is taxable to the person to whom distributed.

Neither Section 171(b) nor Section 162(b) allows a deduction to the estate or trust or taxes to the distributee an amount distributed from principal or tax exempt income of the estate or trust. The only exception is found in Section 162(d), designed to prevent tax avoidance, which provides that a periodic distribution by an estate or trust which can be paid out of funds other than income, shall be considered a distribution of income to the extent of the undistributed income of the estate or trust for the taxable year. That provision has no application to payments from principal, where there is no undistributed income. The statutory provisions show that the courts below erred in holding that the payments here in issue are governed wholly by Section 22(k), and not by Section 171(b), and that payments from principal of an irrevocable trust are taxable as income to the wife.

As we shall show in the annexed brief, the purpose of Sections 22(k) and 23(u) was to shift from the husband to

the wife the burden of the income tax on amounts paid by the husband to the wife, which, had they been retained by the husband, would have been taxable to him; and the purpose of Section 171 was to tax to the wife, rather than to the husband, income of a trust created by the husband which is paid to the wife in discharge of the husband's continuing legal obligation and which under decisions of this Court otherwise would be taxed to the husband.

The statutes in question were enacted in the Revenue Act of 1942. Similar statutes were passed by the Senate in the Revenue Bill of 1941, but final action on those statutes was postponed until 1942. The report of the Senate Finance Committee on the Revenue Bill of 1941, which we quote in the annexed brief, states plainly and unequivocally that where such payments are made to the wife from trust principal, they are not to be taxed as income to the wife. As we show in the brief, there were no differences between the statutes passed by the Senate in 1941 and those finally enacted in 1942 which would make the 1941 statement of the Senate Finance Committee inapplicable to the 1942 statutes or which would require a repetition of those statements in the committee reports covering the 1942 Act. As we show, statements made in the committee reports on the Revenue Bill of 1942 are in complete harmony with the 1941 statements. If the 1942 Act is ambiguous, the clearly expressed intention of a Congressional committee should control in construing it. Such expressed intention demonstrates conclusively that the decisions of the courts below are erroneous.

2.

The decision below is not squarely in conflict with the decision of a court of appeals for another circuit on the same issue, and there has been no other decision by a court of appeals on that issue. However, it is contrary to the reasoning of the Court of Appeals for the Ninth Circuit in *Laughlin's Estate v. Commissioner*, 167 F. 2d 828 (1948).

It is also in conflict with the decision of the Tax Court in *Stewart v. Commissioner*, 9 T. C. 195 (1947), in which decision the Commissioner announced his acquiescence, 1947-2 Cum. Bull. 4. The *Stewart* case and the instant case were decided by different judges of the Tax Court, and neither decision was reviewed by the other judges of that court.

The *Laughlin* case presented the question whether an annual payment to a divorced wife from the estate of her deceased husband, which was not required to be made from income, was deductible by the estate in computing its net income. There was undistributed income of the estate in excess of the payment, and the court held the payment deductible by the estate under Sections 171(b), 162(b) and 162(d), saying that a periodic distribution by an estate or trust, whether or not made from income, is to be treated as a distribution of income *to the extent of current undistributed income.* The same court in *Fairbanks v. Commissioner*, 191 F. 2d 680 (1950), held taxable to the wife under Section 171 payments to her from income on stock placed in trust by the husband to secure such payments. The court said it had held in the *Laughlin* case that similar payments were deductible by the estate of the deceased husband, and that there was no intention to "permit a diminution of the tax on the estate of the husband without sanctioning a corresponding liability of the wife". The court thus made no distinction between amounts deductible by the estate and amounts taxable to the wife, when the payments were made from income or there was undistributed income equal to the payments.

It was held in the instant case that payments from principal of a trust are governed solely by Section 22(k) and that Section 171(b) is not applicable. It was held in the *Laughlin* case that amounts payable from principal of an estate are governed by Section 171(b) and that the payments were deductible by the estate because it had undistributed income equal to the payments. If the court in the *Laughlin* case had concluded that Section 22(k) and not

Section 171(b) applied to amounts payable from principal, it could not have allowed the deduction. That is so because the only provision for deducting payments taxable to the wife under Section 22(k) is found in Section 23(u), and that subsection allows the deduction only to the husband. Deductions allowable to the deceased husband's estate are found only in Section 162(b).

If the court was correct in the *Laughlin* case in applying Section 171(b) to an amount payable from principal, when there was undistributed income from which it might have been paid, it follows in the instant case, where there was no undistributed income, that payments to the wife from trust principal are not taxable as income to her. Certainly, it could not be argued that Section 22(k) applies to distributions from trust principal when there is no undistributed income and that Section 171(b) applies to such distributions when there is undistributed income. Any such artificial distinction finds no justification in the statute.

A wife subject to the jurisdiction of the Court of Appeals for the Ninth Circuit who receives such payments from the principal or tax exempt income of an estate or trust having no undistributed income would not be required to report them as income, but a wife subject to the jurisdiction of the Court of Appeals for the Third Circuit must report such payments. In the interest of uniformity of interpretation of the tax laws throughout the country, this Court should resolve the inconsistency in the decisions of the two circuit courts.

The Tax Court held in *Stewart v. Commissioner*, 9 T. C. 195 (1947), that such payments to the wife from tax exempt interest on municipal bonds received by a trust were not includible in her income. The Court's reasoning was that under the express language of the statute, payments made from a trust are governed by Section 171(b); that under that section the wife is treated as any other beneficiary of the trust, and that such beneficiary is not subject to tax on tax exempt trust income.

Tax exempt trust income does not conceivably occupy a status under the income tax laws different from trust principal. Section 22(b)(4) of the Code excludes from gross income the interest on municipal bonds, and income from that source has exactly the same character under the income tax laws as trust principal or any other item which does not fall within the term "gross income". If the Tax Court's decision in the *Stewart* case was right, its decision here is wrong. The Commissioner's acquiescence in the *Stewart* decision demonstrates the confusion resulting from applying inconsistent rules to two payments which are indistinguishable. Taxpayers should be told by this Court what the correct rule is in such cases.

CONCLUSION.

For the foregoing reasons this petition for a writ of certiorari should be granted.

Dated June 3, 1952.

Respectfully submitted,

PHILIP PRICE,

CARROLL R. WETZEL,

GEORGE CRAVEN,
13th Floor Packard Bldg.,
Philadelphia 2, Pa.,
Attorneys for Petitioner.

BARNES, DECHERT, PRICE,
MYERS & RHOADS,
13th Floor, Packard Bldg.,
Philadelphia 2, Pa.,
Of Counsel.

BRIEF IN SUPPORT OF PETITION.

ARGUMENT.

The Statutory Provisions.

Section 120 of the Revenue Act of 1942 added to the Internal Revenue Code Sections 22(k), 23(u) and 171, designed to deal with payments of alimony or amounts in lieu of alimony. Section 22(k) imposes the tax on the wife and Section 23(u) describes the extent of the husband's corresponding deduction. Section 171 pertains to payments from an estate or trust.

Section 22(k) * includes in the income of a divorced wife periodic payments received by her in discharge of, or attributable to property transferred (in trust or otherwise) in discharge of, the husband's legal obligation under the divorce decree or under a written instrument incident to the divorce. Thus, if a payment to the wife from property transferred by the husband is to be taxed to her under Section 22(k), the property must have been *transferred by the husband in discharge of a legal obligation to the wife imposed upon him* by the decree or by such written instrument. That is not this case. The trust here in issue was created by the husband for his own benefit more than three years prior to the separation agreement and divorce decree, and its creation had nothing whatsoever to do with any obligation of the husband to the wife. Therefore, Section 22(k) does not apply to the payments here in issue.

Section 23(u) allows as a deduction to the husband amounts includible in the wife's gross income under Section 22(k) unless those amounts have already been excluded from the husband's gross income by Section 22(k) itself or by Section 171. Payments attributable to property

* Quoted in full at pages 29-30 in the supplement to this brief.

transferred by the husband are excluded by Section 22(k) and are not therefore a deduction under Section 23(u). The effect of these sections is that the husband is permitted to take deductions for direct payments by him to the wife or payments considered made by him because of his continuing control over the property transferred for the benefit of the wife, but he is not allowed a deduction for payments from property previously transferred by him over which he has no control. In the latter case, however, the tax is imposed directly on the wife rather than on the husband, insofar as the payments are taxed at all.

The last sentence of Section 22(k), on which we rely, is as follows:

> "(In cases where such periodic payments are attributable to property of an estate or property held in trust, see Section 171(b).)"

We contend that the above sentence means that if payments of the character described in Section 22(k) are made from an estate or trust (other than a revocable trust or one under the control of the husband in some other manner), Section 171(b) governs. If so, it cannot be disputed and we don't understand the respondent to dispute, that the payments are taxable to the wife *only* if made out of income or if deemed to be made out of income under Section 162(d) because there is undistributed income of the estate or trust at least equal to the payments.

The respondent, on the other hand, argued in the courts below that the above-quoted language of Section 22(k) must be construed to mean that Section 171(b) applies only where the payment is made out of income of the estate or trust, and that if the payment is made from principal, Section 22(k) alone governs. The Tax Court upheld that contention. The Court of Appeals did not write an independent opinion but merely approved the opinion of the Tax Court.

The quoted language is not confined to payments from trust income, but refers to all payments attributable to property of an estate or trust. But even if Section 22(k) applies to payments from trust principal, it applies *only where the trust was created to discharge the husband's legal obligation.*

Section 171(a) includes in the gross income of the divorced wife trust income which the wife is entitled to receive and which, except for its provisions, would be includible in the husband's gross income, and it excludes such income from the husband's gross income. This provision applies to trust income which is applied in discharge of a continuing legal obligation of the husband, regardless of whether the trust was created before or after the divorce. Even in the absence of such a statutory provision the income was taxable to the wife, and not to the husband, where there was no continuing legal obligation of the husband which the trust income served to discharge. See *Douglas v. Willcuts,* 296 U. S. 1 (1935); *Helvering v. Fitch,* 309 U. S. 149 (1940); *Helvering v. Fuller,* 310 U. S. 69 (1940); *Helvering v. Leonard,* 310 U. S. 80 (1940).

Section 171(b) provides that for the purpose of computing the net income of the estate or trust and the net income of the wife described in Section 22(k) or Section 171(a), the wife shall be considered the beneficiary specified in the supplement of the Code relating to the taxation of income of estates or trusts. The pertinent provisions of that supplement are found in Section 162(b) of the Code, which provides that in computing the net income of an estate or trust, a deduction shall be allowed for an amount of *income* which is to be distributed currently to beneficiaries and that such amount shall be included in the income of the beneficiaries.

It is thus clear that an amount paid to the divorced wife is not taxable to her under Section 171(b) unless it is paid from taxable *income* of the estate or trust. We do

not understand that the respondent disputes our position that if Section 171(b) applies, the payments here in issue are not taxable to Mrs. Welsh.

The question, then, is whether Congress intended that Section 22(k) should tax to the wife amounts paid from the *principal* of an estate or an irrevocable trust and that Section 171 should not control unless the payment is made from taxable income of the estate or trust. The exact words used by Congress were:

> "(In cases where such periodic payments are attributable to property of an estate or property held in trust, see Section 171(b).)"

To paraphrase, the question is whether Congress intended merely to shift the tax burden from husband to wife, as we contend, or, on the contrary, intended to change the basic rule that distributions of principal are not income subject to tax. If Congress intended the latter, as the respondent contends, that intention must be found in Section 22(k), in spite of the direction contained within the parentheses. In other words, the effect of respondent's argument is that in those cases in which trust principal provides the source of periodic payments, the taxing authorities should "see Section 171(b)" but should pay no attention to it and should immediately look back to Section 22(k) to determine the taxability of the property used to make such payments. If this be the meaning of the last sentence of Section 22(k), Congress has exhibited a puckish humor that is unusual in a taxing statute.

History of Statutes.

Prior to the 1942 amendments, alimony payments received by the divorced wife from the husband were not includible in the wife's income. *Gould v. Gould*, 245 U. S. 151 (1917). The Court said that the net taxable income of the husband was not decreased by the payments and that the sum received by the wife could not be regarded as income to her.

It was held in *Douglas v. Willcuts*, 296 U. S. 1 (1935), that where a trust was created by a husband to pay the income to his wife in discharge of an existing alimony obligation and any deficiency in income was to be made up by the husband, and where the trust provisions were approved by the state courts in the divorce decree, the income was taxable to the husband because "it went to the discharge of his legal obligation" under the divorce decree.

Helvering v. Fitch, 309 U. S. 149 (1940), involved a trust created by the husband which was included in a property settlement confirmed in the divorce decree. The husband contended that after the decree there was no further legal obligation on him and that therefore the trust income did not discharge a continuing legal obligation. It was held, however, that in the absence of a showing that the state court was without power to modify the divorce decree so as to change the provisions for alimony, the case must be regarded as falling within *Douglas v. Willcuts*, so that the income was taxable to the husband. There was a similar decision in *Helvering v. Leonard*, 310 U. S. 80 (1940). On the other hand, in *Helvering v. Fuller*, 310 U. S. 69 (1940), where the court found that the Nevada courts retained no power to alter or modify the divorce decree and that the creation of a trust by the husband for the wife was a final discharge of his obligation to the wife, it was held that the income was not taxable to the husband.

The sole purpose of the 1942 amendments was to furnish relief from the hardship and inequity resulting from applying the rule established by the cases cited above, by shifting the burden of the income tax from the husband to the wife. See statement of Randolph E. Paul, Tax Adviser to the Secretary of the Treasury, Hearings before Committee of Ways and Means of House of Representatives, 77th Cong. 2d Sess. (1942), p. 92, which statement appears in the supplement hereto at p. 34. See also reports of House Ways and Means Committee and Senate Finance

Committee on Revenue Bill of 1942, 77th Cong., 2d Sess. H. R. Rep. 2333, pp. 46, 71; Sen. Rep. 1631, p. 83.

The pattern of the statute is to allow a deduction to the husband for payments considered made by him to the wife, and to exclude from his income and tax to the wife payments from income of a trust created by him for her. Payments from the income of a trust are allowed as a deduction, under rules applicable generally to distributions of income by trusts, in computing the net income of the trust itself. The provisions applicable to trusts are also applicable to payments made from the husband's estate after his death.

As pointed out above, even prior to the enactment of the 1942 amendments, trust income paid to the wife was taxable to her unless it discharged a continuing legal obligation of the husband. Section 171(a), then, was designed to deal with the continuing obligation type of case, where the income otherwise would be taxable to the husband. Section 171(b), defining the wife as the "beneficiary", is merely the technical device of the draftsman to identify her as the taxpayer under those other sections of the Code that impose the tax.

There is no evidence in the statutes, or outside them, of any intention to change the settled rule that a beneficiary of a trust is *not* subject to tax on payments of trust principal or of tax exempt income, or of any intention to tax an amount to the wife where there is no provision for a corresponding deduction to the husband.

It is true that Section 22(k) does not distinguish between principal and income (unless the word "attributable" does so) in taxing to the wife amounts attributable to property transferred by the husband "in trust or otherwise" in discharge of his legal obligation. However, the statutory language and the statements in the Congressional committee reports show an intention to tax to the wife payments attributable to property transferred in trust by the husband only when the payment to the wife is actually an in-

direct payment by the husband, and thus its amount would be taxable to the husband if it were not for the statute. See, for example, *Mahana v. United States*, 88 F. Supp. 285 (Ct. of Cls., 1950), cert. denied, 339 U. S. 978 (1950), where a payment by a husband to a trustee for transmission to the wife, to make up a deficiency in trust income, was held taxable to the wife. Other examples could be cited, such as payments to the wife from a trust over which the husband has reserved a power to revoke or to change the disposition of the fund.

Moreover, Section 22(k) does not purport to apply where, as here, the creation of the trust had no connection with the husband's obligation under the separation agreement or divorce decree but was created by him for his own benefit some years earlier. The only reference in Section 22(k) to payments from such a trust is the parenthetical reference to Section 171(b).

The Legislative Intent.

The statute itself contains no provisions which require the inclusion of payments made from the trust principal in the wife's income. If there were any doubt about this, the legislative history clearly shows that Congress did not intend to tax such payments to the wife.

Provisions similar to those of Section 22(k), 23(u) and 171 of the Code first appeared in Section 117 of the Revenue Bill of 1941, as passed by the Senate. That section is set forth in the supplement, beginning at p. 32.

The only differences of substance between those sections as they appeared in the 1941 Bill and as they were enacted in 1942 are:

(a) The proposed 1941 amendments made no distinction between husband and wife, but taxed payments to the receiving spouse, whether husband or wife, and allowed the payments as a deduction to or excluded them from the income of the other spouse. The stat-

utes enacted in 1942 tax the payments to the wife only and allow them as deductions to or exclude them from the income of the husband only.

(b) Section 22(k) of the 1941 statute did not contain the parenthetical words "(in trust or otherwise)" contained in the present Section 22(k).

(c) Section 171 of the proposed 1941 statute dealt only with payments from a trust and not with those from an estate and contained no provisions similar to the present 171(b), treating the wife as a beneficiary and specifying the year in which payments from trust income are includible in the wife's gross income. Correspondingly, Section 22(k) of the proposed 1941 statute referred to Section 171 and not, as at present, to Section 171(b).

Those differences are immaterial here and would not justify a different conclusion as to the treatment of payments from trust principal.

In the conference between committees of the Senate and the House on the Revenue Bill of 1941, those provisions of the 1941 Bill were eliminated with the statement that the conferees had deferred action on the amendment "with the understanding that it will be considered in a later bill dealing with administrative matters." H. R. Rep. No. 1203, 77th Cong., 1st Sess., p. 11.

Since the amendments enacted in 1942 were but a reenactment, with the changes not material here, of the statutes passed by the Senate in 1941, the statements made by the Senate Finance Committee in connection with the 1941 Bill are helpful in construing the statute enacted in 1942.

The report of that committee states that Section 171 "is designed to include in the gross income of an individual who is divorced or legally separated under a decree of divorce or separate maintenance the amount of the income of any trust such individual is entitled to receive which, except for the provisions of Section 171, would be includible in the

income of such individual's spouse or former spouse, and to exclude such amount from the gross income of such spouse or former spouse" (Sen. Rep. No. 673, Part 1, 77th Cong., 1st Sess., p. 33). The committee report then sets forth the following highly significant examples of the operation of the statute:

> "The operation of this section (and its relation to section 22(k) and section 23(u)) may be illustrated by the following examples (in which it is assumed that all payments are made and received within taxable years beginning after December 31, 1941):
>
> "(1) As part of a separation agreement, Mr. X transfers property to a trust, the net income of which is estimated by the parties to be sufficient to provide for Mrs. X's support. A few years later Mrs. X obtains a divorce from Mr. X. The final decree refers to the trust created previously under the separation agreement and provides that the transfer in trust and the income therefrom receivable by Mrs. X shall be in lieu of alimony. The court, however, retains, as is allowed under the law of the State in which the divorce is obtained, jurisdiction to provide for further payments to Mrs. X by Mr. X should the income of the trust be insufficient for her support. Under section 171 the net income of the trust is income to Mrs. X and is not income to Mr. X.
>
> "(2) Under the same facts as in the previous example the decree of the court provides that in all events Mrs. X shall receive $10,000 a year as alimony. In the first taxable year beginning after December 31, 1942, the net income of the trust is only $8,000. The trustees, therefore, pay an additional $2,000 from the corpus of the trust to Mrs. X. *In such a case only $8,000 is includible in the income of Mrs. X under the provisions of section 171.* No part of the trust income is includible in the gross income of Mr. X nor is he

allowed any deduction for any part of the $10,000 paid to Mrs. X. However, if the additional $2,000 is not payable out of the corpus of the trust but is payable by Mr. X to Mrs. X, then the $2,000 paid by Mr. X to Mrs. X is income to her under section 22(k). Therefore, for 1942 Mrs. X includes $10,000 in her income, Mr. X does not include in his income the $8,000 paid to Mrs. X by the trust but is entitled to deduct the $2,000 paid by him to Mrs. X. (Emphasis supplied.)

"(3) Mr. Y is the beneficiary of a trust established under the will of his father. Under the terms of the trust, the trustees are to pay to Mr. Y $10,000 a year from the net income of the trust, but if the net income of the trust for any year does not equal $10,000, to pay the net income and so much more from the corpus of the trust as will total $10,000. In 1942 Mrs. Y obtained a divorce from Mr. Y. Under the divorce decree Mr. Y is to pay Mrs. Y $5,000 a year for his life. To meet this obligation under the divorce decree, Mr. Y assigned to Mrs. Y for five years one-half of the amount he is otherwise entitled to receive from the trust, promising to make another such assignment or to provide another method of payment of the $5,000 a year to her at the expiration of that period. In 1942 the net income of the trust is $8,000. Under the terms of the trust instrument and of the assignment by Mr. Y to Mrs. Y the trustees pay $5,000 to Mr. Y and $5,000 to Mrs. Y. *Since only eight-tenths of the amount thus distributed represents the net income of the trust, only $4,000 of the amount received by Mrs. Y is income to her.* Mr. Y will include in his income only $4,000 and will not include any amount on account of the $5,000 paid to Mrs. Y."* (Emphasis supplied.)

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* Note: The Treasury regulations contain an illustration of the treatment of payments to the divorced wife from trust principal which is directly contrary to the above statement by the Senate Finance Committee. Reg. 111, Sec. 29.23-(u)-1, Example (2). However, regulations may not prevail over the clearly expressed intention of Congress. *Koshland v. Helvering*, 298 U.S. 441, 447 (1936); *M. E. Blatt Co. v. United States*, 305 U.S. 267, 279 (1938).

Patently, the above examples establish that it was the intention of the Senate in 1941 that where payments are made to a divorced wife from a trust created by the husband or from an interest which he has assigned in a trust created by another, the amounts includible in the wife's income are limited to payments made from trust income.

This intention was not departed from in any way in the statutes as finally enacted. Mr. Randolph E. Paul, spokesman for the Treasury Department, in his statement before the Ways and Means Committee on the Revenue Bill of 1942 (Hearings before the Committee on Ways and Means on Revenue Revision of 1942, 77th Cong., 2nd Sess., p. 92) said:

> "The fair solution is that recommended by the Senate last year, namely to tax alimony payments to the divorced wife. We suggest that this solution be adopted."

The amendments were adopted in accordance with Mr. Paul's suggestion.

There is still further evidence that the Congressional intention in 1942 was identical with the Senate's intention in 1941. The report of the House Ways and Means Committee on the 1942 Bill makes the following statement (H. R. Rep. No. 2333, 77th Cong., 2nd Sess., p. 46):

> "However, in the case of trusts created prior to the divorce or separation and not included * thereto, the wife is required to include in the gross income only the amount of the income of the trust which she is entitled to receive and which, under existing law, would be taxed to the husband. The bill excludes such amount from the gross income of the husband."

The respondent relied in the court below on the following statement in the committee reports on the 1942 Act (Sen. Rep. No. 1631, 77th Cong., 2d Sess., p. 84):

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* Should be "incident."

"The full amount of periodic payments received under the circumstances described in section 22(k) is required to be included in the gross income of the recipient whether such amounts are derived, in whole or in part, from income received or accrued by the source to which such payments are attributable. Thus, it matters not that such payments are attributable to property in trust, to life insurance, endowment or annuity contracts, or to any other interest in property, or are paid directly or indirectly by the obligor husband from his income or capital. Section 22(b)(2) is amended to make this result clear with respect to those amounts received from life insurance, endowment, and annuity contracts which otherwise would be excluded from gross income under section 22(b)(1) and (2)."

That language is applicable only when the transfer is made by the husband to the wife or is considered as made by him because of his control over the property from which the payment is made. It can have no application when the wife proceeds as a creditor after her husband's death, as in this case, against property which her deceased husband had irrevocably transferred in trust for his own benefit long prior to the separation agreement or divorce decree.

No one can give any sound reason for supposing that Congress would have wished to tax such payments to the wife where no corresponding income tax deduction is allowable to the husband's estate or to the trust. Congress in dealing with such trusts intended to abolish all distinction between cases where there was a continuing obligation to the wife under the state law and those where the creation of the trust discharged finally the husband's obligation, and to create a uniform rule that in all cases payments from trust income should be taxed to the wife. Clearly that is all Congress intended to do. There was no intention to change the settled rule that payments from trust principal or from nontaxable trust income are free of tax to the recipient,

just as they would be free of tax if they were retained and not paid out.

The Confused State of the Law.

In *Laughlin's Estate v. Commissioner*, 167 F. 2d 828 (C. A. 9, 1948), a husband and his wife in 1924 entered into a separation agreement, later incorporated in a divorce decree, which provided that the husband or his estate would pay to the wife $800 a month for support and maintenance. In 1942, after the husband's death, his estate made the payments to the wife and claimed a corresponding income tax deduction under Section 171(b). There was no requirement that the payment be made out of income and there was no showing that it was made from income. The Tax Court (8 T. C. 33 (1947)) held the payment not deductible under Section 171(b) because it was not required to be made from income and therefore the wife could not be considered an income beneficiary under that subsection. The Court of Appeals reversed, saying that the undistributed income of the estate for the taxable year exceeded the payments to the wife and that under Section 162(d) such payments are to be considered payments of income *if they do not exceed the distributable income for the taxable year*. The court accordingly held the payments deductible by the estate under Sections 171(b) and 162(b) of the Code.

Fairbanks v. Commissioner, 191 F. 2d 680 (C. A. 9, 1951), cert. denied March 31, 1952, 72 S. Ct. 648, involved a divorced wife's income tax on payments received from income on stock placed in trust by her deceased husband to secure such payments. The Tax Court (15 T. C. 62 (1950)) and the Court of Appeals held the payments taxable to the wife under Section 171. The Court of Appeals said it was impossible to conclude from its decision in the *Laughlin* case that it had intended to permit a deduction to the husband's estate without sanctioning a corresponding liability to the wife. The court thus regarded as correlative the questions whether a payment is deductible under Section

171 by the husband's estate and whether it is taxable under that section to the wife.

In *Reid's Estate v. Commissioner* and the companion case of *Izrastzoff v. Commissioner*, 15 T. C. 573 (1950), there was no requirement that the payments to the divorced wife be made out of income. However, since the income of the deceased husband's estate exceeded the payments to the wife, it was held that the payments were deductible by the estate and taxable to the wife under Sections 171(b) and 162(b) of the Code. That decision was affirmed by the Court of Appeals for the Second Circuit, 193 F. 2d 625 (1952), but there was no issue before the court concerning the source of the payments or whether Section 171(b) applied.

If the Court of Appeals in the *Laughlin* case had concluded that Section 171(b) applies only where payments are made from income of an estate or trust, it could not have reached the conclusion which it reached in that case, which did not involve payments from income. The same is true of the Tax Court's decisions in the *Reid* and *Izrastzoff* cases.

The Court of Appeals for the Third Circuit in the instant case did not write an opinion, but said (R. 22):

> "The Tax Court ruled in the affirmative on the two questions and we are in complete accord with its disposition for the reasons so well stated in its opinion, 16 T. C. 1398."

The Tax Court in its opinion below said (R. 18a):

> "Nor do we agree with petitioner's argument that section 171 must be looked to rather than section 22(k). The Report of the Senate Finance Committee referred to above, at page 85, shows that section 171 states the rules applicable to trust or estate *income* after a decree of divorce in the case of a trust created prior to divorce and to which the *provisions of section 22(k) are not applicable.* As above indicated, we think section 22(k) is applicable here and since the payments to the wife

are to be made from trust corpus and not from trust *income,* section 171 is not brought into play so far as taxability to the wife is concerned. Nor do we find anything in the sections read together which would indicate that if the payments come from corpus they are not to be included in the wife's gross income."

Apparently the Tax Court imagined that it should find something in the sections read together that would indicate that payments from corpus are *not* to be included in the wife's gross income, and, finding nothing, concluded to tax such payments. Distributions of principal are not income, and it would be a matter of surprise and not of expectation to find a capital levy in an income tax statute. Congress, in making Section 171(b) controlling where property of an estate or property held in trust is involved, obviously considered it self-evident that any tax was to be levied on, and collected out of, *income* alone and therefore found it unnecessary to say more than that the wife be considered a *beneficiary* of the trust for the purpose of computing its and her *net income.* No one in drafting such a provision could reasonably be expected to have thought it necessary to say in addition that no capital levy was intended or that not more than 100% of the income was to be considered taxable. The Tax Court now says in effect that because it finds no such provision it concludes that payments from the principal of the fund made in satisfaction of a judgment must be taxed as if they were income *in addition* to taxing *all* the *actual* income from the fund.

The only reason why such a notion can be entertained is because the Commissioner has now clearly repudiated his former acquiescence in the *Stewart* decision, although he has not withdrawn it, and the Tax Court has ignored not only its own decision in the same case but also the reasoning of the Court of Appeals in the *Laughlin* case.

In the *Laughlin* case the Court of Appeals for the Ninth Circuit has held that a payment from principal of an estate

is governed by Section 171(b). The Court of Appeals for the Third Circuit, by approving the opinion of the Tax Court in the instant case, has held that such payments are governed by Section 22(k) alone and not by Section 171(b). It seems clear that the reasoning of the one court is in conflict with that of the other.

Stewart v. Commissioner, 9 T. C. 195 (1947), is in conflict with the decision of the courts below in the instant case. That case held under Section 171(b) that a wife was not taxable on payments made to her from tax exempt trust income in discharge of the husband's obligation. That case may not be distinguished from the instant case on the ground that it involved tax exempt trust income and not trust principal. Tax exempt trust income is excluded from gross income by Section 22(b)(4) of the Code and is therefore necessarily in the same category as trust principal. If one is within Section 171(b), the other is likewise governed by that section. The Commissioner's acquiescence in the *Stewart* decision (1947-2, Cum. Bull. 4), which has never been withdrawn, shows that at one time he recognized the correctness of the position which the petitioner takes here; but in spite of that, he now takes precisely the opposite position on the same question.

The injustice of the Commissioner's present contention is apparent and should not be upheld unless no other construction of the law is reasonably possible. He now claims that all the income of a trust fund is taxable to the recipients of it, a contention the correctness of which petitioner does not challenge; but he also claims that, in addition to an income tax on all the *income*, an income tax is payable on so much of the *principal* of the trust as is required to pay petitioner's claim as a creditor of her husband's estate. It is completely foreign to the whole scheme of the income tax law, and of the Sixteenth Amendment to the Constitution, to make taxable as income an amount greater than the *entire* income from a fund, and it is a repudiation of the well-known definitions of "income" con-

tained in the law itself, to tax as income what are admittedly merely portions of the principal of a fund. A much clearer expression of such a purpose on the part of Congress should be required than is to be found here, before such an interpretation of the tax law is adopted.

If the petitioner were one of the beneficiaries of the trust and received some or all of the taxable income of the fund, such income would, of course, be subject to income tax to be paid by her; but she would not be so taxable if the income distributable to her were, by definition, "tax free" income. It is submitted that she is no less exempt from income tax when what she receives is a distribution of principal, which is not *income* at all, and particularly when it has been obtained by her not pursuant to but in derogation of the terms of the trust and merely as a creditor of her deceased husband's estate. The mere fact that she gets her payments of principal in instalments does not make them income, and it is submitted that to tax them as such is not required by anything in the existing law.

Cases are certain to arise each year involving tax treatment of such payments from principal or tax exempt income of an irrevocable trust created by a husband or received from a deceased husband's estate. The confusion growing out of the inconsistent and conflicting cases discussed above is such that it is impossible to say with certainty whether the payments are deductible by the estate or trust and are taxable to the wife. The question must be decided eventually by this Court, and much confusion and injustice would be avoided if the Court should grant the present petition and declare the proper interpretation of the law in question.

CONCLUSION.

In order to resolve the grave doubt about the correctness of the decision below, to forestall wide and protracted litigation and to enable taxpayers to prepare their income tax returns correctly, it is respectfully submitted that a writ of certiorari should be granted.

Dated June 3, 1952.

Respectfully submitted,

PHILIP PRICE,

CARROLL R. WETZEL,

GEORGE CRAVEN,
13th Floor Packard Bldg.,
Philadelphia 2, Pa.,
Attorneys for Petitioner.

BARNES, DECHERT, PRICE,
MYERS & RHOADS,
13th Floor Packard Bldg.,
Philadelphia 2, Pa.,
Of Counsel.

SUPPLEMENT TO PETITION AND BRIEF.

Sections 22(k), 23(u) and 171 of Internal Revenue Code, as in Force in 1948.

"SEC. 22. GROSS INCOME.

"(k) Alimony, Etc., Income.—In the case of a wife who is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, periodic payments (whether or not made at regular intervals) received subsequent to such decree in discharge of, or attributable to property transferred (in trust or otherwise) in discharge of, a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by such husband under such decree or under a written instrument incident to such divorce or separation shall be includible in the gross income of such wife, and such amounts received as are attributable to property so transferred shall not be includible in the gross income of such husband. This subsection shall not apply to that part of any such periodic payment which the terms of the decree or written instrument fix, in terms of an amount of money or a portion of the payment, as a sum which is payable for the support of minor children of such husband. In case any such periodic payment is less than the amount specified in the decree or written instrument, for the purpose of applying the preceding sentence, such payment, to the extent of such sum payable for such support, shall be considered a payment for such support. Installment payments discharging a part of an obligation the principal sum of which is, in terms of money or property, specified in the decree or instrument shall not be considered periodic payments for the purposes of this subsection; except that an installment payment shall be considered a periodic payment for the purposes of this subsection if such principal sum, by the

terms of the decree or instrument, may be or is to be paid within a period ending more than 10 years from the date of such decree or instrument, but only to the extent that such installment payment for the taxable year of the wife (or if more than one such installment payment for such taxable year is received during such taxable year, the aggregate of such installment payments) does not exceed 10 per centum of such principal sum. For the purposes of the preceding sentence, the portion of a payment of the principal sum which is allocable to a period after the taxable year of the wife in which it is received shall be considered an installment payment for the taxable year in which it is received. (In cases where such periodic payments are attributable to property of an estate or property held in trust, see section 171(b))."

• • •

"SEC. 23. DEDUCTIONS FROM GROSS INCOME.

"(u) Alimony, Etc., Payments.—In the case of a husband described in section 22(k), amounts includible under section 22(k) in the gross income of his wife, payment of which is made within the husband's taxable year. If the amount of any such payment is, under section 22(k) or section 171, stated to be not includible in such husband's gross income, no deduction shall be allowed with respect to such payment under this subsection."

"SEC. 171. INCOME OF AN ESTATE OR TRUST IN CASE OF DIVORCE, ETC.

"(a) Inclusion in Gross Income.—There shall be included in the gross income of a wife who is divorced or legally separated under a decree of divorce or separate maintenance the amount of the income of any trust which such wife is entitled to receive and which, except for the provisions of this section, would be includible in the gross income of her husband, and such amount shall not, despite section 166, section 167 or any other provision of this chap-

ter, be includible in the gross income of such husband. This subsection shall not apply to that part of any such income of the trust which the terms of the decree or trust instrument fix, in terms of an amount of money or a portion of such income, as a sum which is payable for the support of minor children of such husband. In case such income is less than the amount specified in the decree or instrument, for the purpose of applying the preceding sentence, such income, to the extent of such sum payable for such support, shall be considered a payment for such support.

"(b) Wife Considered a Beneficiary.—For the purposes of computing the net income of the estate or trust and the net income of the wife described in section 22(k) or subsection (a) of this section, such wife shall be considered as the beneficiary specified in this supplement. A periodic payment under section 22(k) to any part of which the provisions of this supplement are applicable shall be included in the gross income of the beneficiary in the taxable year in which under this supplement such part is required to be included."

* * *

Section 117(a), (b) and (c) of Revenue Bill of 1941 (H. R. 5417, 77th Cong., 1st Sess.) as Passed by Senate.

"SEC. 117. ALIMONY AND SEPARATE MAINTENANCE PAYMENTS.

"(a) Amount Includible in Gross Income.—Section 22 (relating to definition of gross income) of the Internal Revenue Code is amended by inserting at the end thereof the following new subsection:

'(k) Alimony, Etc., Income.—In the case of an individual who is divorced or legally separated from a spouse under a decree of divorce or of separate maintenance, periodic payments received (subsequent to and such amounts received as are attributable to property transferred in discharge of, a legal obligation imposed upon or incurred by such individual's spouse or former spouse under such decree or under a written instrument incident to such divorce or separation shall be includible in the gross income of such individual, and such amounts received as are attributable to property so transferred shall not be includible in the gross income of such other spouse or former spouse. This subsection shall not apply to that part of any such periodic payment which, by the terms of the decree or written instrument, is specifically designated as a sum payable for the support of minor children of the spouses. Installment payments discharging a part of an obligation the principal sum of which is, in terms of money or property, specified in the decree or instrument, shall not be considered periodic payments for the purposes of this subsection. (For amount includible under this subsection in case the property is held in trust, see section 171.)'

"(b) Deduction for Amounts Paid—Section 23 of the Internal Revenue Code (relating to deductions from gross

income) is amended by inserting at the end thereof the following new subsection:

'(u) Alimony, Etc., Payments.—In the case of an individual, amounts includible under section 22(k) in the gross income of a spouse (or former spouse) of such individual, payment of which is made within the individual's taxable year. If the amount of any such payment is, under section 22(k) or section 171, excluded from such individual's gross income, no deduction shall be allowed with respect to such payment under this subsection.'

"(c) Income from Trusts.—Supplement E of the Internal Revenue Code is amended by inserting at the end thereof the following new section:

'SEC. 171. TRUST INCOME IN CASE OF DIVORCE, ETC.

'There shall be included in the gross income of an individual who is divorced or legally separated under a decree of divorce or of separate maintenance the amount of the income of any trust such individual is entitled to receive which, except for the provisions of this section, would be includible in the gross income of such individual's spouse or former spouse, and such amount shall not, despite section 166, section 167, or any other provision of this chapter, be includible in the gross income of such spouse or former spouse. This section shall not apply to that part of any such periodic payment which, by the terms of the decree or trust instrument, is specifically designated as a sum payable for the support of minor children of the spouse.' "

Statement of Randolph E. Paul, Tax Adviser to Secretary of Treasury, on Revenue Revision of 1942 (Hearings Before Committee of Ways and Means, 77th Cong., 2nd Sess., p. 92).

"8. ADDITIONAL EXAMPLES OF HARDSHIPS AND INEQUITIES.

"A. Income taxes.—(a) Alimony.—Generally speaking, alimony payments are not subject to tax in the hands of a divorced wife. Even where irrevocable trusts have been established, and the husband has no further interest in the trust property, the income of the alimony trust is nevertheless taxable to him because it is used to pay an alimony obligation. Rising tax rates have in some cases absorbed the entire income of the husband required to pay the tax on his income and that of his divorced wife. At the same time, divorced wives receiving tax-free alimony possess a privileged status under our tax laws which relieves them of any share of the tax burden.

"The fair solution is that recommended by the Senate last year, namely to tax alimony payments to the divorced wife. We suggest that this solution be adopted."

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and Regulations involved	2
Statement	2
Argument	6
Conclusion	11
Appendix	12

CITATIONS

Cases:

Fairbanks v. *Commissioner*, 191 F. 2d 680	7, 10
Izrastzoff v. *Commissioner*, 193 F. 2d 625	7
Laughlin's Estate v. *Commissioner*, 167 F. 2d 828	7, 9, 10
Reid, Estate of v. *Commissioner*, 15 T.C. 573, affirmed *sub nom. Izrastzoff* v. *Commissioner*, 193 F. 2d 625	10
Stewart v. *Commissioner*, 9 T.C. 195	10

Statute:

Internal Revenue Code:	
Sec. 22 (26 U.S.C. 22)	6, 7, 8, 9, 10, 12
Sec. 23 (26 U.S.C. 23)	12
Sec. 143 (26 U.S.C. 143)	2, 7
Sec. 162 (26 U.S.C. 162)	8, 9
Sec. 171 (26 U.S.C. 171)	7, 8, 9, 10, 13
Sec. 211 (26 U.S.C. 211)	2, 7

Miscellaneous:

S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 84-85 (1942-2 Cum. Bull. 504, 569)	8, 9
Treasury Regulations 111:	
Sec. 29.22(k)-1	9, 14
Sec. 29.23(u)-1	16
Sec. 29.171-1	8, 17